85-288

Supreme Court, U.S.
FILED
AUG 6 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. ____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

JACK DEANE and JOSEPH DEANE,

Petitioners,

v.

THOMSON MCKINNON SECURITIES, INC.
PEAT, MARWICK, MITCHELL & CO.
MEDICAL AND BUSINESS FACILITIES
(A Louisiana Limited Partnership)

Respondents.

On Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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HOPP

QUESTIONS PRESENTED

I. Did the Court of Appeals act contrary to precedents established by this Court in affirming the District Court's dismissal of Petitioner's Complaint brought to enforce civil remedies under the Securities Act and Exchange Act?

II. Did the Court of Appeals err in failing to rule on the availability to Petitioners of a private right of action under Section 17 of the Securities Act?

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OPINIONS BELOW

Plaintiffs appeal from the order of the Court of Appeals for the District of Columbia Circuit (App. A) affirming the Memorandum Opinion of the District Court of April 30, 1984 (App. B) which dismissed Appellant's Second Amended Complaint without leave to amend.

JURISDICTION

The Court has jurisdiction of this matter pursuant to 28 U.S.C. § 201(c) to review an important question under the federal securities laws which has been erroneously decided by a Federal Court of Appeals in conflict with applicable decisions of this Court.

FEDERAL STATUTES

This case involves the following federal statutes the full text of which is set out in Appendix C.

1. Section 17(a), Securities Act of 1933, 15 U.S.C. 77q(a)(1), Appendix C.

2. Rule 10b-5 under the Securities Exchange Act of 1934, 17 CFR 240.10b-5, Appendix C.

STATEMENT OF THE CASE

Petitioners brought this action for recission of the sale of securities sold to them in violation of the Securities Act of 1933 [15 U.S.C. 77q(a)(1)] ("Securities Act") and Rule 10b-5 promulgated under the Securities Exchange Act of 1934 [17 C.F.R. 240.10b-5] ("Exchange Act"). The securities, Hospital Revenue Bonds of New Orleans General Hospital Corp. ("Bonds") were sold to Petitioners through an "Official Statement". 1/

As directed in an order dismissing petitioners' Amended Complaint, Petitioners'

1/ The Official Statement is a prospectus-like document setting forth material facts concerning the issuer, on which prospective purchasers can rely. the term "Official Statement" is utilized to differentiate the documents from a "Prospectus" denoting that it is the source of representations relative to the offering of a security, exempt from the registration under the Securities Act.

Second Amended Complaint set forth representations made in the Official Statement alleged to be false or misleading; the true state of facts; the source from which the truth was ascertained and the factual predicate for a showing of scienter on the part of the defendants. The same procedure was repeated for the representations and statements in the Feasibility Study included in the Official Statement

The allegations in the Complaint fell into three categories. First, misrepresentations and omissions as to the quality of Management. Second, misrepresentations and omissions with respect to accounting and financial matters. Third, misstatements in the Feasibility Study relating to the ability of the Issuer to pay debt service. The materiality of the quoted representations and omissions were

conceded in the Official Statement to be crucial to the operation of the Issuer as a new corporate entity.

REASONS FOR GRANTING THE PETITION

I. THE COURT OF APPEALS ACTED CONTRARY TO PRECEDENTS ESTABLISHED BY THIS COURT IN AFFIRMING THE DISTRICT COURT'S DISMISSAL OF PETITIONER'S COMPLAINT

The Court of Appeals and District Court adopted artificial pleading requirements for a private right of action under the Securities Act and Exchange Act contrary to principles established by this Court in Herman & Maclean v. Huddelston, 103 S.Ct. 683 (1983), where this Court invalidated artificial proof requirements in Securities Act cases.

The Lower Courts applied a more stringent pleading standard than would be required in pleading common law fraud. In the present case, a sophisticated

securities deception, where proof will depend on extensive discovery of management systems and records, the Lower Courts' requirements deny a defrauded investor an opportunity to maintain an action.

This Court has held that the provisions of the securities laws are not coexistent with common law doctrines of fraud. "Indeed, an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common law protections by establishing higher standards of conduct in the securties industry." Herman & Maclean v. Huddleston, supra. The cases relied upon by the Trial Court and Court of Appeals go far beyond "specificity" and impose a standard requiring an investor to plead all available evidence. The Lower Courts relied on

Decker v. Massey Ferguson, Ltd., 681 F.2d 111 (2d Cir. 1982); Ross v. A.H. Robbins, 607 F.2d 545 (2d Cir. 1979); Segal v. Gordon, 467 F.2d 602 (2d Cir. 1972); Crystal v. Foy, 562 F. Supp. 422 (S.D.N.Y. 1983).

The rationale of the cases relied on by the Lower Court was that the artificial pleading requirement was necessary "to prevent strike suits", Crystal v. Foy, supra, or "the protection of the good name of the defendants", Segal v. Gordon, supra, p. 607. On the basis of this Judicial Legislation, the District Court stayed discovery and required petitioners to plead all available evidence in the complaint, presumably for the Trial Court to determine whether the claim was a "strike suit" before discovery could be commenced.

Petitioners alleged in their complaint that specific statements in the official

statement utilized to sell the Bonds were false. Further, Petitioners described the source from which plaintiffs concluded that these statements were, in fact, false. The sources were reports to securities holders and an audit report which plaintiff was able to obtain.

The Auditor and the Bond Indenture Trustee's reports were dismissed by the District court as being "conclusory statements." The Court lost sight of the fact that the conclusions were not conclusions of Petitioners or Counsel, but of expert witnesses who could have testified to these conclusions.

The Second Amended Complaint quoted representations made in the Official Statement, such as:

> "The hospital administration has instituted certain internal and external review processes. The internal processes involve intensive reviews intended to permit the identification of developing trends and establishment of a reliable information system."

which alleged that the representatins were false and contrasted the representations with statements in the Auditors' report stating:

> "The hospital has not maintained certain customary accounting records and supporting documents relating to transactions with its patients and suppliers, nor in our opinion, is the system of internal controls adequate to provide safeguards over its assets and assure the proper recording of transactions.

The District Court's Order, dismissing the Second Amended Complaint without leave to amend, required Petitioners to detail the basis of the Accountant's opinion by specifying the Book required and those which were not maintained. Since discovery had been suspended by order of the Court, Petitioners could not obtain these details.

Artificial pleading requiremens are contrary to the pleading philosophy of the Federal Rules of civil Procedure and

thwart a federal securities act claim more effectively than the artificial proof requirements voided by this Court in Herman & MacLean v. Hudleston, supra.

The following quotes from the cases relied upon by the District Court and Court of Appeals contrasted with quotations from Herman & MacLean v. Huddleston, supra demonstrate the disparity of concept:

Decker v. Massey Ferguson, Ltd., supra,

> "It is a serious matter to charge a person with fraud and hence no one is permitted to do so unless he is in a position and is willing to put himself on record as to what the alleged fraud consists of specifically."

Ross v. A.H. Robinson Co., supra,

> "In the context of securities litigation, Rule 9(b) serves an additional important purpose. It operates to diminish the possibility that 'a plaintiff with a largely groundless claim (will be able) to simply take up the time of a number of other people (by extensive discovery) with the right to do so representing an in terrorem increment of the settlement value, rather than a reasonable hope that the process will reveal relevant evidence'"

Crystal v. Foy, supra,

> "For this reason, courts have been careful to protect against those who would abuse the federal discovery rules as "a hunting license to conjure up a claim that does not exist.'"

In contrast, this Court stated in

Herman & MacLean v. Huddleston, supra,

> "The interests of defendants in a securities case do not differ qualitatively from the interests of the defendnats sued for violations of other federal statutes such as the antitrust or civil rights laws, for which proof by a propoundance of the evidence suffices. On the other hand, the interets of plaintiffs in such suits are significant. Defrauded investors are among the very individuals Congress sought to protect in the securites laws. If they prove tht it is more likely than not that they were defrauded, they should recover."

II. THE COURT OF APPEALS ERRED IN FAILING TO CONSIDER THE AVAILABILITY OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17 OF THE SECURITIES ACT.

The Court of Appeals declined to decide whether a private right of action was available under Section 17(a) of the Securities Act. this allowed the

opinion of the trial Court to stand on this issue.

The Trial Court stated:

> "The weight of case authority suggests, however, that an implied right of action is doubtful and unavailable."

This holding glosses over fifty years of conflicting holdings on the availability of private right of action under 17(a) of the Securities Act.

Prior to this Court's decision in Aaron v. SEC, 446 U.S. 680 64 L.Ed. 2d 611 (1980), Section 17(a) was generally combined with Section 10(b) in private right of action cases and most of these cases were decided under 10(b) because of the apparently more flexible language.

The lower Courts that sought to differentiate between Rule 10b-5 of the Exchange Act and 17(a) of the Securities Act have done so on the theory that Section 11 and 12 of the Securities Act

contains specific private rights, thet were not applicable to actions under 10(b).

In this case, Section 11 and 12 of the Securities Act are not available to plaintiff. Section 11 deals with false statements in a prospectus (which was not utilized) and Section 12 specifically excludes its applicability to securiites exempt under Section 3(a)(2) of the Securities Act. The Securities Act, however, specifically provides in Section 17(c), "The exemptions provided in Section 3 shall not apply to the provisions of this section." Thus, a private right must be implied to provide redress under the Act.

This Court held that the availability of an express remedy under the Securities Act did not

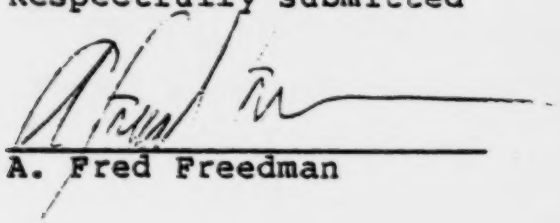
preclude a defrauded purchaser of stock from maintaining an action under the Exchange Act. The Court also pointed out that the express remedies under the Securities Act were not exclusive under the act. Herman & Maclean v. Huddleston at p. 688.

The reasoning of the Court in Herman & MacLean, supra, makes it clear that the Court does not view actions under Sections 11 and 12 as exclusive under the Securities Act. In the instant case, where no express right of action applies to a violation of the act, it cannot be doubted that the Supreme Court should imply a private right of action.

CONCLUSION

Based upon the foregoing a writ of certiorari should issue.

Respectfully submitted



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Second Amended Complaint was mailed, first class mail, postage prepaid on the 1st day of March, 1984, to:

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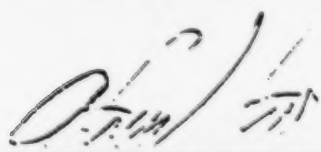

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APPENDICES

A P P E N D I X A

UNITED STATES COURT OF APPEALS
For the District of Columbia Circuit

NO. 84-5342 September Term, 1984
Civil Action No. 83-01114

Jack Deane, individually and
for all others similarly situated, et al.,

v.

Thomson McKinnon Securities, Inc. et al.

APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF COLUMBIA

Before: WRIGHT and SCALIA, Circuit Judges,
and *MARKEY, Chief Judge.

J U D G M E N T

Plaintiffs' appeal from District Judge Barrington D. Parker's dismissal with prejudice of their second amended complaint alleging statutory and common law violations arising out of their purchase of revenue bonds issued by a New Orleans hospital. Specifically, they claim that the Official Statement through which the bonds were issued and an accompanying Feasibility Study contained material misrepresentations

regarding the hospital's managerial and accounting practices. The issues presented have been accorded the Court's full consideration; they occasion no need for an opinion. See D.C. Cir. R. 13(c). It is

ORDERED and ADJUDGED, by this Court, that the dismissal of the complaint is affirmed. Courts I and II allege violations of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 1984), and Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(1982), by defendants Medical and Business Facilities, which allegedly controlled the issuing hospital; Thomson McKinnon Securities, Inc., the underwriter for the bond issue; and Peat, Marwich & Mitchell Co., the accounting firm that prepared the feasibility study accompanying the Official Statement. For

the reasons stated in his opinion of April 30, 1984, we affirm Judge Parker's ruling that the complaint with respect to these Counts did not satisfy the pleading requirements of Fed. R. Civ. P. 8(a) and 9(b). See Segal v. Gordon, 467 f.2d 602, 606-08 (2d cir. 1972). In affirming, we expressly do not decide whether a private civil action for damages can be brought under § 17(a).

Count III alleges that Thomson McKinnon breached its common law duty as an underwriter "to exercise care and skill of their [sic] profession, and to deal with customers with candor." Complaint ¶ 42. As counsel for plaintiff acknowledges, there is no basis for federal jurisdiction over this claim if it cannot be pended to the federal securities law claims, and dismissal of Counts I and II therefore compels dismissal

of Count III as well. See United Mine Workers of America v. Gibbs, 383 U.S. 715, 726 (1966).

AFFIRMED.

Per Curiam
For The Court

George A. Fisher
Clerk

* Of the United States Court of Appeals for the Federal Circuit, sitting by designation pursuant to 28 U.S.C. § 291(a).

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

JACK DEANE, et al., Plaintiffs,	)	
v.	)	Civil Action No. 83-1114
THOMSON McKINNON SECURITIES, INC., et al., Defendants.	)	

MEMORANDUM OPINION

Barrington D. Parker, District Judge:

On April 18, 1983, Jack Deane and Joseph Deane filed a complaint on behalf of themselves and others similarly situated charging the defenants with violations of the federal securities laws--the Securities Act of 1933 and the Securities Exchange Act of 1934. Named as defendants were Thomson McKinnon Securities, Inc. ("McKinnon"), a registered broker-dealer; Peat, Marwick, Mitchell & Co. ("Peat, Marwick"), an accounting firm; and the

New Orleans General Hospital Corporation ("Hospital"), an issuer of hospital revenue bonds. The plaintiffs alleged that they sustained losses and damages after purchasing Hospital revenue bonds through McKinnon, the underwriter of the bonds. The complaint also alleged that plaintiffs received "a preliminary official statement dated June 15, 1981, which included...a feasibility study prepared by [Peat, Marwick]" for the Hospital (Complaint ¶ 2). As relief the plaintiffs demanded "judgment against the Defendants ...for rescission of the offering...." (Complaint p. 4).

Thereafter, the three defendants moved to dismiss the complaint for failure to state a claim upon whih releif could be granted, rule 12(b)(6) Federal Rules of Civil Procedure. On August 11, 1983, an order of dismissal without prejudice

was entered. The complaint was dismissed because the plaintiffs failed to state a cognizable claim against the defendants and failed to comply with the basic pleading requirements of civil procedure, Rule 8(a)(2), (e)(1) and Rule 9(b). More specifically, the plaintiffs failed to particularize in the complaint what provisions, if any, of the 1933 and 1934 federal securities acts were relied upon and they failed to note what actions or conduct were taken by any defendant which violated particular provisions of the two statutes. In short, the loosely worded complaint was fatally flawed and fell far short of charging the defendants with any breach of duties or violations of law insofar as the plaintiffs were concerned.

On September 6, 1983, the plaintiffs filed an amended complaint which was also challenged by the defendants. This first amended complaint, while somewhat of an

improvement over the original effort, was nontheless dismissed on February 9, 1984. In dismission the plaintiffs' second effort, without prejudice, the Court noted at page 3 of the Order of Dismissal that while the new complaint was lenthier than the first, "the only change of significance is that the Amended Complaint now alleges violations of specific subsections of the federal securities acts. In other respects, however, the Amended Complaint is as deficient as the original, and does not meet the requirements of specificity for complaints alleging securities fraud." The Court then pointed to the unresolved problems presented by the plaintffs' second effort and noted the relevant and controlling case law associated with those problems.

The plaintiffs then filed a Second Amended Complaint on March 1, 1984.

Meanwhile on January 31, 1984, the New Orleans General Hospital Corporation filed notice in this proceeding that on January 13, 1984, it had filed a petition for bankruptcy in the United States Bankruptcy Court for the Eastern District of Louisiana. The plaintiffs then named the defendant Medical and Business Facilities ("Business Facilities"), a Louisiana limited partnership, in place of the Hospital.

At this time the Court is again called upon to decide motions to dismiss filed by McKinnon and Peat, Marwick. For the reasons set out below, it is determined that the Second Amended Complaint does not reflect any significant improvement and should dismissed. This dismissal, however, is with prejudice.

The plaintiffs' third effort alleges: that the Hospital was "controlled" by the defendant, Business Facilities; that in

June and July 1981, the two defendants prepared and caused to be issued an Official Statement which was later disseminated to prospective purchasers in connection with the offer and sale of the bonds; that McKinnon was the underwriter for the bonds; and that on August 8, 1981, the plaintiffs purchased the Hospital's bonds through McKinnon. the Second Amended Complaint then presents and tracks in detail language from various provisions of the Official Statement. Attached to and included as part of that document was a Feasibility Study prepared by Peat, Marwich and a July 24, 1981, transmittal letter from those accountants to the Hospital. The Feasibility Study presented an analysis of the Hospital's financial forecast as set out in the Official Statement.

The plaintiffs assert three causes of action against the plaintiffs.

Count I of the complaint charges all defendants with "violations of Section 17(a)(1) of the Securities Act [of 1933], 15 U.S.C. 77q(a)(1) and Section 10(b) of the [Securities] Exchange Act [of 1934], 15 U.S.C. 78j(b) and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5." Count II, based on the same allegations, charges all defendants with "violations of Section 17(a)(2) and (3) of the Securities Act [of 1933], 15 U.S.C. 77q(a)(2) and (3). Count III charges only McKinnon with violation of an underwriter's duty of care and skill of his profession toward the plaintiffs and to deal with them in candor.

The plaintiffs' present effort, as was true of the two earlier pleadings, is still lacking and deficient. Most notably, they fail to assert what portions, if any, of the Official Statement are false or misleading and in what manner. They fail to particularize or specify what

statements are actionable as to a defendant and fail to provide sufficient factual predecate to support a securities fraud claim as to a defendant. They continue to rely upon conclusory allegations and a mere recitation of the language of the two federal securities statutes in thier pleading.

As to the Peat, Marwick Feasibility Study, other than generalizations and ambiguous references and statements as to fraud, there is no claim that the accountants' Feasibility Study contained false and misleading statements. Also Peat, Marwick makes a timely and relevant observations, namely, that nowhere in the Second Amended Complaint do the plaintiffs ever claim or allege tht they read and relied upon the Feasibility Study.

The Deanes seek to bolster their latest effort by including and quoting from portions of a later prepared audit

report undertaken by Aucoin, Sanchez and Paul, an independent Louisiana accounting firm. The audit was performed at the request of a Louisiana bank serving as the indenture trustee for the bond issue (Complaint ¶¶ 13-16) and covered the Hospital's financial statements and operations over an 11-months period, through December 31, 1981.

The audit report did not discuss, comment, or criticize Peat, Marwick's Feasibility Study or the Hospital's projections referenced therein. Also the report disclaimed any opinions on the Hospital's financial statements for the 11-month period ending December 31, 1981. "We are not in a position to, nor was the scope of our work sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to above." (Complaint ¶ 15).

Count I charges all defendants with a violation of Section 17(a) of the 1933 Securities Act. The plaintiff's reliance upon that section as to Peat, Marwick is premised upon the theory of an implied private damage remedy. The weight of case authority suggests, however, that an implied private right of action is doubtful and unavialable. The Supreme Court decision, Aaron v. SEC, 446 U.S. 680, 689 (1980) left open the question as to whether 17(a) gives rise to a private right of action. Subsequent to Aaron various courts have held that Section 17(a) provides no implied right of action for damages. See, Keys v. Wolfe, 709 F.2d 413, 416 (5th cir. 1982); Landry v. All American Insurance Company, 688 F.2d 381, 384-91 (5th Cir. 1982); Summer v. Land & Leisure, Inc., 571 F. Supp. 380, 386-87 (SD Fla. 1983); Kimmel v. Peterson,

565 F. Supp. 476, 482-88 (ED Pa. 1983).

Section 17(a) proscribes unlawful conduct "in the offer or sale of any securities." The plaintiffs do not content that Peat, Marwick offered or sold any hospital bonds to them and thus the theory of liability as to the accountants is presumable that of secondary liability as an aider or abetter. The criteria for deteriming Section 17(a) liability of the aider or abetter are well settled and clear. Senior Judge David Bazelon of our Circuit Court noted that the following elements must be established: "1) another party has committed a securities law violation; 2) the accused aider and abetter had a general awareness that his role was part of an overall activity that was improper; and 3) the accused aider and abetter knowing and substantially assisted the principal violation."

Investors Research, et al. v. S.E.C., 628 F.2d 168, 178 (D.C. Cir.) (citing Woodward v. Metro Bank of Dallas, 522 F.2d 84 (5th Cir. 1975)), cert. denied, 499 U.S. 919 (1980). The same view was announced even more recently, Dirks v. SEC, 681 F.2d 824, 844 (D.C. Cir. 1982); rev'd on other grounds, 103 S.Ct 3255 (1983). In view of this it is clear that as to Peat, Marwick, the present amended complaint must be dismissed for none of the requisite elements of aiding and abetting liability have been alleged in any manner.

Under Section 10(b) of the 1934 Act and rule 10(b)5 upon which the plaintiffs also rely, scienter is a basic element of a securities fraud claim. Ernst & Ernst v. Hockfelder, 425 U.C. 185 (1976); Ross A. H. Robins, 607 F.2d 545, 556 (2d Cir.), cert. denied, 446 U.S. 946 (1980). After three efforts, the plaintiffs have not

provided sufficient factual support demonstrating scienter as to McKinnon and Peat, Marwick. In count I the plaintiffs allege that the "Defendants knew, should have known or recklessly disregarded the managerial and acocunting difficulties of the [Hospital] and disseminated an Official Statement which painted the management and accounting systems in glowing terms" (Complaint ¶ 33). Other than this innocous and meaningless statement the plaintiffs have failed to satisfy the particularity requirements of rule 9(b) F. R. Civ. P. To establish Section 10(b) and rule 10(b)5 violations under the civil procedure rule the complaint must allege specific facts, sources that support the alleged specific facts and a basis from which an inference of fraud may fairly be drawn. Crystal v. Foy, 562 F. Supp. 423-425 (S.D.N.Y. 1983). The general broadside allegations

set out in the plaintiff's amended applications fall short.

The plaintiffs have characterized the Third Count asserted against the udnerwriter, McKinnon, as a common law claim -- breach of duty. McKinnon rejects that characterization and contends that it is a fraud claim and thus is subject to the more stringent requirements of pleading. Whatever label is utilized, the Count suffers from the same malady as found generally with the plaintiffs' several efforts. It is written loosely and does not provide sufficient information to frame a meaningful response. It does not define or set out the nature and scope of the duty owed or breached and thus McKinnon does not have a fair and adequate notice of the cliams asserted by the plaintiffs. Rule 8(a) F. R. Civ. P. provides in part that a claim shall include "(1) a short and plain statement

of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiciton and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief,..." Even a generous reading of Count III would not support the plaintiffs' last pleading effort charging breach of McKinnon's common law duty owed by an underwriter to a purchaser of securities.

The Deanes have been advised more than once what is required to state a securities fraud claim and have had ample opportunity to comply. Their continual difficulties and inability to satisfy a cause of action perhaps suggest that they do not have a viable cause of action.

Finally, nowhere in the Second Amended Complaint do the plaintiffs allege a cause of action sufficient to support a

claim of securities fraud against Business Facilities. And thus the court on its own initiative dismisses the Complaint against that defendant.

On the basis of the entire record in this proceeding, this action is dismissed with prejudice.

Entered: April 30, 1984

/s/ Barrington D. Parker
Barrington D. Parker
United States District Judge

E X H I B I T C

FRAUDULENT INTERSTATE TRANSACTIONS

Section 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly --

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which

operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, through not pur_ por ting to offer a security for sale, describes such security for a considera_ tion received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 3 shall not apply to the provisions of this section.

EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Supreme Court, U.S.
FILED
SEP 19
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-288

IN THE

Supreme Court of the United States

OCTOBER TERM 1985

JACK DEANE and JOSEPH DEANE,

Petitioners,

—v.—

THOMSON MCKINNON SECURITIES, INC., PEAT, MARWICK, MITCHELL & CO. and MEDICAL AND BUSINESS FACILITIES (A Louisiana Partnership),

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. Whether the courts below erred in holding that the petitioners had failed to state a claim upon which relief could be granted under the federal securities laws when, after three attempts to do so, petitioners failed to identify the statements they claimed were false or misleading or the conduct of each defendant that allegedly provided a predicate for their claims.

2. Whether the Court of Appeals erred in declining to decide whether a private right of action is available under Section 17(a) of the Securities Act of 1933 when, even assuming the existence of such a right of action, petitioners had failed to allege the essential elements of such a claim.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-288

JACK DEANE and JOSEPH DEANE,

Petitioners,

—v.—

THOMSON MCKINNON SECURITIES, INC., PEAT, MARWICK, MITCHELL & CO. and MEDICAL AND BUSINESS FACILITIES (A Louisiana Partnership),

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

STATEMENT OF THE CASE

Petitioners purchased revenue bonds issued in 1981 to finance the acquisition, renovation and reopening of New Orleans General Hospital which had ceased operation in 1979 and was just emerging from bankruptcy as a newly formed corporation.

The bonds were offered by means of an Official Statement which, petitioners alleged, incorporated certain hospital-prepared financial projections for the annual periods ending

September 30, 1981 through September 30, 1985 and a "financial feasibility study" (*not* an audit) of the hospital's future plans for facilities modification allegedly prepared by respondent Peat, Marwick, Mitchell & Co. ("Peat Marwick"). Petitioners did not allege that they ever read or relied upon the Official Statement or the feasibility study, nor did they allege that Peat Marwick conducted any audit of the hospital or rendered any opinion on any of its financial statements.

Almost a year after the offering, the hospital's independent auditors, Aucoin, Sanchez & Hall, completed an audit of the hospital's financial statements for its first 11 months of operation—i.e., the period ending December 31, 1981 — and issued a report thereon which, *inter alia*, disclaimed any opinion on those financial statements and noted certain deficiencies in the hospital's record-keeping and system of internal control existing at the time of the audit.

Petitioners commenced this action in 1983 against the hospital, the underwriter of the bonds and Peat Marwick. Their initial complaint, which did not even identify what provisions, if any, of the federal securities laws they purported to sue under, was dismissed without prejudice by the District Court for failure to comply with the basic pleading requirements of the Federal Rules of Civil Procedure. Fed. R. Civ. P. 8(a)(2), 8(e)(1), 9(b). Petitioners' amended complaint, which merely added references to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) (the "1934 Act"), and Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982) (the "1933 Act"), was similarly dismissed by the District Court with leave to amend.

When, however, petitioners' second amended complaint proved to be no better than its predecessors, the District Court dismissed it with prejudice, stating that petitioners had failed to identify what statements they claimed were false or misleading and what action or inaction by each defendant allegedly provided a predicate for their claims and had failed to allege that they read or relied upon the feasibility study. The District Court's opinion is reported at 586 F. Supp. 44 (D.D.C. 1984).

The District Court's dismissal was affirmed by the Court of Appeals in a *per curiam* judgment.

REASONS FOR DENYING THE WRIT

I. DISMISSAL OF THE COMPLAINT WAS BASED ON ESTABLISHED PRECEDENT

Petitioners' second amended complaint was dismissed on the ground that it failed to allege the basic elements of a claim and sought to predicate charges of fraud solely on the hindsight observation that financial forecasts for a newly formed entity were not flawless. No wrongful acts by Peat Marwick were alleged, nor were any facts alleged from which an inference of fraudulent intent—*scienter*—on the part of Peat Marwick may fairly have been drawn.

Under the established precedents on which the courts below relied, petitioners' complaint was properly dismissed. *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 114 (2d Cir. 1982) ("a complaint 'must allege with some specificity the acts constituting the fraud' . . ."); *Segal v. Gordon*, 467 F.2d 602, 607 (2d Cir. 1972) (" 'there must be allegations of facts amounting to deception in one form or another . . .' ").

As this Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976), *scienter* is an essential element of a violation of Section 10(b) of the 1934 Act. At minimum, a complaint must allege facts that give rise to an inference of fraudulent knowledge or intent. *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978).

Petitioners failed after three attempts to satisfy these fundamental pleading requirements. Dismissal was plainly appropriate under the circumstances.[1]

---

1 *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), on which petitioners rely, addressed the issue of burden of proof in actions under Section 10(b) and has no bearing on the requirement that petitioners plead the basic elements of their claim for relief.

II. THE COURT OF APPEALS WAS CORRECT IN DECLINING TO DECIDE WHETHER A RIGHT OF ACTION SHOULD BE IMPLIED UNDER SECTION 17(a) OF THE 1933 ACT

This Court has four times raised and left open the question whether Section 17(a) of the 1933 Act gives rise to an implied private damage remedy. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733-34 n.6 (1975); *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 557 n.9 (1979); *Aaron v. SEC*, 446 U.S. 680, 689 (1980); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 378 n.2 (1983). The issue also remains unresolved in the District of Columbia Circuit, *Wachovia Bank & Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342, 350 n.19 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981), in the First Circuit, *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 780 (1st Cir. 1983), in the Second Circuit, *Yoder v. Orthomolecular Nutrition Institute, Inc.*, 751 F.2d 555, 559 n.3 (2d Cir. 1985); *Zerman v. Ball*, 735 F.2d 15, 23 (2d Cir. 1984); *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 945 (2d Cir. 1984), and in the Seventh Circuit, *Peoria Union Stock Yards Co. v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 323 (7th Cir. 1983).[2]

2 Subsequent to this Court's decision in *Aaron v. SEC*, 446 U.S. 680 (1980), lower courts reaching the issue have been virtually unanimous in the view that no implied private right of action for damages exists under Section 17(a). *See, e.g., Keys v. Wolfe*, 709 F.2d 413, 416 (5th Cir. 1983), *aff'g in pertinent part*, 540 F. Supp. 1054, 1060 (N.D. Tex. 1982); *Landry v. All American Assurance Co.*, 688 F.2d 381, 384-91 (5th Cir. 1982); *Wayne Investment, Inc. v. Gulf Oil Corp., [1983-1984] CCH Fed. Sec. L. Rep.* ¶ 99,612 at 97,409 (D. Mass. 1983), *aff'd*, 739 F.2d 11 (1st Cir. 1984); *Ackerman v. Clinical Data, Inc.*, [Current] CCH Fed. Sec. L. Rep. ¶ 92,207 at 91,569-71 (S.D.N.Y. 1985); *Weiss v. Gibson*, [1984-1985] CCH Fed. Sec. L. Rep. 92,090 at 91,467 (D.D.C. 1985); *Sheftelman v. N.L. Industries, Inc.*, [1984-1985] CCH Fed. Sec. L. Rep. ¶ 92,040 at 91,190-91 (D.N.J. 1985); *North American Financial Group, Ltd. v. S.M.R. Enterprises, Inc.*, 583 F. Supp. 691, 695-97 (N.D. Ill. 1984); *Summer v. Land & Leisure, Inc.*, 571 F. Supp. 380, 386-87 (S.D. Fla. 1983); *Kimmel v. Peterson*, 565 F. Supp. 476, 482-88 (E.D. Pa. 1983); *Sweeney v. Keystone Provident Life Insurance Co.*, 578 F. Supp. 31, 33 (D. Mass. 1983); *Massaro v. Vernitron Corp.*, 559 F. Supp. 1068, 1078 (D. Mass. 1983); *Basile v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 551 F. Supp. 580 (S.D. Ohio 1982); *Hill v. Der*, 521 F. Supp. 1370, 1378 (D. Del. 1981) (collecting and analyzing cases), *adhered to Hill v. Equitable Trust Co.*, 562 F. Supp. 1324 (D. Del. 1983).

Consistent with these precedents, the Court of Appeals declined to reach the issue of whether a private right of action for damages should be allowed under Section 17(a) of the 1933 Act in view of petitioners' failure to allege the basic elements of such a claim, even assuming that it were to exist.

In the absence of an adequate pleading and of a decision on the issue by the Court of Appeals, there is no reason for this Court to address the Section 17(a) question at this time.

CONCLUSION

Petitioners fail to state any sound reason for this Court to grant certiorari. No important question of federal law has been presented nor did the Court of Appeals render a decision on a federal question in conflict with the decisions of this Court or another federal court of appeals. Accordingly, Peat Marwick respectfully submits that the petition for writ of certiorari should be denied.

Respectfully submitted,

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No. 85-288

(3)

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IN THE

Supreme Court of the United States

October Term, 1985

JACK DEANE and JOSEPH DEANE,

Petitioners,

vs.

THOMSON McKINNON SECURITIES INC., PEAT, MARWICK, MITCHELL & CO. and MEDICAL AND BUSINESS FACILITIES (A Louisiana Limited Partnership),

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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COUNTERSTATEMENT OF THE QUESTION PRESENTED FOR REVIEW

Whether the court of appeals acted properly in affirming the district court's dismissal of Petitioners' second amended complaint with prejudice after Petitioners had failed, in their complaint, amended complaint and second amended complaint, adequately to plead a cause of action upon which relief can be granted and after the district court, in dismissing the two prior complaints, had put Petitioners on plain notice of the deficiencies of each complaint and had given Petitioners opportunities to correct those deficiencies.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1985

JACK DEANE and JOSEPH DEANE,

Petitioners,

-against-

THOMSON McKINNON SECURITIES INC., PEAT, MARWICK MITCHELL & CO. and MEDICAL AND BUSINESS FACILITIES (A Louisiana Limited Partnership),

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Respondent Thomson McKinnon Securities Inc. ("Thomson McKinnon") respectfully submits this brief in opposition to Jack Deane's and Joseph Deane's petition for a

writ of certiorari to review the order and judgment of the United States Court of Appeals for the District of Columbia Circuit that was entered on May 8, 1985.

STATEMENT OF THE CASE

Ostensibly on behalf of themselves and all others similarly situated, Petitioners commenced this action on or about April 18, 1983, alleging in an entirely conclusory fashion that they had been defrauded, in violation of the federal securities laws, in connection with their purchase of bonds issued by the New Orleans Hospital Corporation (the "Hospital") during its 1981 offering of $10 million in revenue bonds (the "1981 Offering").

Originally named as defendants were Thomson McKinnon, the underwriter for the 1981 Offering, Peat, Marwick, Mitchell & Co. ("Peat, Marwick"), an accounting firm that prepared and provided a feasibility study in connection with the 1981 Offering,

and the Hospital. Although the bases, if any, of Petitioners' allegations remain unclear, Petitioners apparently contend that Thomson McKinnon and Peat, Marwick materially misrepresented the condition, financial and otherwise, of the Hospital. Specifically, Petitioners contend, among other things, that the June 14, 1981 official statement (the "Official Statement") provided to them in connection with their purchase of the Hospital bonds was false and misleading.

The district court permitted Petitioners three attempts to plead an adequate cause of action. Each time they fell woefully short of stating any cognizable claim against Thomson McKinnon, Peat, Marwick, or any other defendant. After Petitioners' third futile attempt,

the district court, with more than adequate legal basis, dismissed Petitioners' second amended complaint with prejudice.

Petitioners' original complaint (the "Complaint") and their amended complaint (the "Amended Complaint")[1] were egregiously insufficient documents that wholly failed to provide adequate notice to the defendants of the claims against them. The Complaint contained only six paragraphs of substantive allegations, despite the fact that it purported to claim fraud against three separate defendants, and failed even

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1 In these complaints, Petitioners alleged, among other things, violations of Section 17(a) of the Securities Act of 1933, (the "Securities Act"), 15 U.S.C. § 77q(a), and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78(j).

to enumerate the provisions of the federal securities laws that allegedly were violated.

The Amended Complaint wholly failed, as did the Complaint, to specify the statements constituting the alleged fraud, the parties and/or persons that made the statements, or the circumstances under which the statements allegedly were made. Once again, Petitioners relied solely upon conclusory allegations and provided absolutely no basis for their claims.

Accordingly, on August 11, 1983 and February 9, 1984, respectively, the district court dismissed the Complaint and the Amended Complaint. Both times, the district court dismissed Petitioners' action without prejudice, permitting them a

third opportunity to plead an adequate cause of action.

On March 1, 1984, nearly a year after they first commenced this lawsuit, Petitioners filed their second amended complaint (the "Second Amended Complaint"). Despite the district court's two prior admonitions, Petitioners continued in their Second Amended Complaint to employ the conclusory and unsupported allegations and bald recitations of statutory language that plagued their earlier pleadings. As the district court observed:

> The plaintiffs' present effort, as was true of the two earlier pleadings, is still lacking and deficient. Most notably, they fail to assert what portions, if any, of the Official Statement are false or misleading and in what manner. They fail to particularize or specify what statements are actionable as to a defendant and fail to provide

> sufficient factual predicate to support a securities fraud claim as to a defendant. They continue to rely upon conclusory allegations and a mere recitation of the language of the two federal securities statutes in their pleading.

(A. 7-8).[2]

Accordingly, on April 30, 1984, the district court, in a nine page Memorandum Opinion, dismissed the Second Amended Complaint with prejudice and noted: "[t]he Deanes have been advised more than once what is required to state a securities fraud claim and have had ample opportunity to comply. Their continual difficulties and inability to satisfy a cause of action perhaps suggest that they do not have a viable cause of action." (A. 15).

---

2 References to "(A __)" are to Petitioners' Appendix.

On appeal, the court of appeals held: "For the reasons stated in his opinion of April 30, 1984, we affirm Judge Parker's ruling that the complaint with respect to these Counts did not satisfy the pleadings requirements of Fed. R. Civ. P. 8(a) and 9(b). [citation omitted]. In affirming, we expressly do not decide whether a private civil action for damages can be brought under Section 17(a)." (A. 2).

In sum, Petitioners were afforded three opportunities adequately to plead a cause of action against Thomson McKinnon and Peat, Marwick. After each of the first two failed attempts, the district court delineated the deficiencies of the pleading at issue and the action required to remedy those deficiencies. Nevertheless, Petitioners failed equally in their third

attempt. Certainly, under these circumstances, the court of appeals acted properly in affirming the district court's dismissal of the Second Amended Complaint with prejudice.

ARGUMENT

I

THE COURT OF APPEAL'S AFFIRMANCE OF THE DISTRICT COURT'S DISMISSAL OF PETITIONERS' SECOND AMENDED COMPLAINT WAS ENTIRELY PROPER AND IN CONFORMITY WITH THE LAW

Utilizing inapposite precedent, Petitioners argue that the court of appeals acted contrary to law in affirming the district court's dismissal of the Second Amended Complaint with prejudice. Since the court of appeal's affirmance was wholly in conformity with the Federal Rules of Civil Procedure and with well established legal precedent, Petitioners' argument must fail.

In support of their argument, Petitioners rely on a single case recently decided by this Court: Herman & MacLean v.

Huddleston, 459 U.S. 375 (1983). Quoting various verbatim statements in Justice Marshall's opinion out of context, Petitioners apparently question entirely the basis and legality of the specificity requirements imposed by Rule 9(b) of the Federal Rules of Civil Procedure ("Rule 9(b)"). Huddleston, however, is entirely inapposite.

Huddleston, a purported class action instituted under Section 10(b), addressed, among other things, "the standard of proof applicable to actions under § 10(b)." Id. at 379. Justice Marshall, noting that this Court traditionally has limited the application of the clear and convincing evidence burden of proof, held that the preponderance-of-the-evidence standard, not the clear and convincing evidence standard,

would govern actions brought under Section 10(b). Thus, in Huddleston, this Court held merely that "if [a securities fraud plaintiff] prove[s] that it is more likely than not that . . . [he was] defrauded, . . . [he] should recover." Id. at 390. Huddleston has absolutely no applicability to the pleading requirements of Rule 9(b).

In fact, Huddleston also intimated this Court's concern that "defendants face the risk of opprobrium that may result from a finding of fraudulent conduct." Id. at 390. It is this concern over the opprobrium that may result from the allegation of fraudulent conduct that Rule 9(b) is designed to address. Rule 9(b), which provides that "[i]n all averments or fraud or mistake, the

circumstances constituting the fraud or mistake shall be stated with particularity," is designed "to protect defendants from the harm that comes to their reputations or to their goodwill when they are charged with serious wrongdoing." Segal v. Gordon, 467 F.2d 602, 607 (2d Cir. 1972).

This Court has acknowledged that the policy expressed in Rule 9(b) is particularly important in securities litigation. In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), Justice Rehnquist explained that a securities law "complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at a trial so long as he may

prevent the suit from being resolved against him by dismissal or summary judgment." Id. at 740. The particularity requirement of Rule 9(b) reduces the possibility of suits where "a plaintiff with a largely groundless claim [will] . . . simply take up the time of a number of people, with the right to do so representing an in terrorum increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence."[3] Id. at 741.

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3 One may easily conclude, from the fact that after three attempts over the course of a year Petitioners still cannot plead a sufficient claim, that this lawsuit is frivolous and brought in bad faith.

Despite prior admonitions from the district court to comply with the basic pleading requirements of the Federal Rules of Civil Procedure, Petitioners failed in their Second Amended Complaint, as they had twice previously, to state a cognizable claim against Thomson McKinnon. The Second Amended Complaint was fraught with the same vague and conclusory allegations and bald recitations of statutory language that afflicted Petitioners' two prior complaints. In view of Petitioners' repeated failures to cure the deficiencies by the amendments previously allowed, the court of appeals acted properly in affirming the district court's dismissal of the Second Amended Complaint with prejudice.[4]

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4 Petitioners argue that they should have been permitted discovery in order

(Footnote continued)

(Footnote cont'd from previous page)

to allow them to uncover facts that allegedly would support their fraud claims. This attempt to abuse the discovery process only makes it clearer that Petitioners seek here not to redress a wrong, but to find one.

To permit Petitioners to conduct discovery before they have succeeded in stating any cognizable claim against Thomson McKinnon would be a clear abuse of the discovery process. "Complaints should not be conceived merely as tokens, guaranteeing access to a world of discovery. . . . Neither plaintiff nor his counsel are entitled to roam through a defendant's files at the mere drop of a 'complaint'." Denny v. Barber, 73 F.R.D. 6, 10 (S.D.N.Y. 1977), aff'd, 576 F.2d 465 (2d Cir. 1978). See also Edwards v. Gordon & Co., 94 F.R.D. 584, 586 (D. D.C. 1982).

Moreover, to allow Petitioners to utilize discovery before complying with the requirements of Rule 9(b) would violate Rule 9(b)'s purpose. Rule 9(b) "is designed to require plaintiffs to obtain sufficient information to aver fraud by the time the complaint is filed and to prevent use of the lawsuit as a search for that information." Ross v. Warner, 480 F. Supp. 268 (S.D.N.Y. 1979).

II

THE COURT OF APPEALS ACTED PROPERLY IN DECLINING TO CONSIDER THE AVAILABILITY OF A PRIVATE RIGHT OF ACTION UNDER THE SECURITIES ACT OF 1933

Petitioners argue, erroneously, that the court of appeals acted improperly in failing to decide the issue whether a private civil action for damages can be brought under Section 17(a) of the Securities Act ("Section 17(a)"). The court of appeals, however, did not have to reach that issue. Accordingly, the petition for a writ of certiorari must be denied.

Contrary to Petitioners' assertions, a review of the district court's opinion dismissing the Second Amended Complaint reveals that the district court dismissed

Petitioners' Section 17(a) claim totally because of their failure to comply with the basic pleading requirements of the Federal Rules of Civil Procedure.[5] Since the issue of the availability of a private right of action was therefore not properly before the court of appeals, the court of appeals did not have to reach that issue.

Accordingly, the court of appeals acted properly in expressly not deciding the issue whether a private civil action for damages is available under Section 17(a). The petition for a writ of certiorari therefore must be denied.

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5 Although the district court stated in passing that "[t]he weight of the case authority suggests . . . that an implied right of action is doubtful and unavailable" (A. 10), this statement clearly was intended merely as an observation, and certainly not as a basis for dismissal of the Second Amended Complaint.

CONCLUSION

Having failed in three efforts over the course of a year to plead an adequate cause of action, Petitioners cannot rightfully contend that the court of appeals acted improperly in affirming the district court's dismissal of the Second Amended Complaint with prejudice. Thomson McKinnon therefore respectfully requests that the petition for a writ of certiorari be denied.

Dated: New York, New York
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